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SUBJECT: CHINDIA: TALES OF SYNERGY PREMATURE

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¶1. (SBU) SUMMARY: During a January swing through India's high-tech heartland, including Hyderabad and Bangalore, visiting Washington-based econoffs met with India's leading software firms and discussed the challenges these firms face in the China market. Most felt that the media hype about "Chindia," the teaming of China's high-tech manufacturing with India's software prowess, was premature. Interlocutors felt that the two countries would be increasingly competing in high-tech manufacturing, while the demand for the type of high-end information technology (IT) services for which Indian firms excel is still small from indigenous Chinese firms. Most Indian software firms continue to view China as a location to provide services for multinational customers who have a presence there. Several companies expressed concern about the challenges of doing business in China. Business representatives mentioned onerous registration policies and the increasing cost of doing business as barriers to expanding their china presence. Nevertheless, all of the leading Indian IT firms told econoffs they planned to increase their presence in China in the near term. END SUMMARY.

INDIAN SOFTWARE FIRMS LOOK TO EXPAND MARKET PRESENCE

¶2. (SBU) During January visits to leading Indian software companies, Infosys, Wipro, and Satyam, econoffs discussed the current state of key software sectors where Indian companies compete globally. These include business process outsourcing (BPO), information technology services, and application programming (AP). India's software exports are expected to reach \$60 billion by 2010, with 40 percent stemming from BPO and 60 percent from AP and IT services. Leading Indian IT firms also talk about moving up the "value chain" to so-called transformation BPO and knowledge process outsourcing (KPO), which involve efforts to become deeply enmeshed with a large multinational firm's entire business process and to help it move in new directions.

THE CHINA CONNECTION

¶3. (SBU) In Hyderabad, visiting econoffs met with Satyam Computers, India's number four software player. After taking econoffs through an elaborate high-tech multi-media introduction to Satyam, which was laced with the jargon of globalization and software development, Satyam Corporate Strategy Chief Subbarao Machiraju Subbu described Satyam's overall posture in the software market. The firm employs

35,000 "associates" and has a market capitalization of \$7.0 billion.

Satyam currently has 26 global solution centers, including a newly opened site in Egypt. The firm services over 520 customers (mostly in North America and Europe) providing application development, consulting and BPO, and infrastructure management services. Satyam's customers tend to be smaller multinational corporations.

¶4. (SBU) Satyam appears bullish on the China market, and has opened offices in Shanghai (Pudong), Dalian, Beijing, Guangzhou, and Hong Kong. Satyam has found the China market challenging because of the requirements placed on foreign businesses, such as the need to register in each different city in China where it opens an office. Satyam executives also were concerned about the cost of doing business in China. Social security costs are very high, according to Machiraju, and because there is no bond system in place, Satyam's investment in training personnel is not protected. It is also very difficult to move associates in China because of the requirements for Hukou (residence permits), which increases costs. Machiraju mentioned a new labor law which is quite stringent and will, he believes, further increase the cost of doing business in China. Like most companies looking to expand their BPO and IT services in China, Satyam is trying to attract back Chinese PhD students studying in the United States who want to work in a global market environment.

¶5. (SBU) In Bangalore, econoffs met with Wipro, the third leading Indian software firm. Corporate treasurer R. Rajesh Ramaiah provided a detailed look at Wipro's global operations and its views of the China market. Wipro has been the most cautious of the leading Indian IT firms in expanding its China presence. As an older more established firm, Wipro provides traditional global IT services (such as BPO services) and is also a reseller of hardware for leading U.S. firms, such as Sun Microsystems and Cisco Systems. Wipro also has other business lines such as a line of hydraulics equipment.

¶6. (SBU) Wipro currently has a China-based staff of 100 located in Shanghai and Beijing and plans to increase to between 500-1000 by 2008. It currently views China primarily as a delivery center for IT services for global customers in Asia. Ramaiah noted that Wipro

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has major concerns about the protection of intellectual property in China. So far, Wipro has primarily recruited in China via the traditional route of receiving and evaluating resumes and has not yet visited the campuses of leading Chinese IT educational institutions. Ramaiah indicated, though, that this is likely to change soon as Wipro considers increasing the size of its China footprint.

¶7. (SBU) Ramaiah noted that China had some advantages in the software sector including heavy government support for software companies, as well as educational support. He noted that Chinese software firms tend to be small; there are no firms in China as large as the four major Indian players. Wipro sees Chinese software firms as a threat on the low-end of the IT services continuum, such as localization, and in the R&D area, where China remains a pricing threat because of the low cost of its engineering talent. Ramaiah echoed Satyam officials in noting that Indian firms such as Wipro are hoping to move farther up the value chain as China begins to nibble at the lower end of the software and IT services sectors. He mentioned specifically KPO as an area for future Wipro emphasis.

INFOSYS: SHOWCASE OF THE STARS

¶8. (SBU) Bangalore also features the plush headquarters compound of Infosys, the "Microsoft" of India. (COMMENT: As Infosys had been the target of some recent terrorist threats, security was tight at the compound entrance. END COMMENT.) Infosys Associate Vice President and head of the "China Effectiveness Center" Srinivasulu Mallampooty provided a tour of the campus and outlined the Infosys vision during econoffs' stay.

¶9. (SBU) Infosys currently has a staff of 750 in China, primarily in Shanghai and Hangzhou. The Infosys China vision, as explained by

Mallampooty, was two pronged. First, Infosys views China as a platform for serving its global customers. He cited the example of Motorola China. Infosys had recently lost a BPO contract for Motorola China to IBM China. However, because IBM China did not perform up to standard, Infosys had been invited back to participate. To do this Infosys had pulled together a global team composed of 1) Indians with telecom experience working in the United States, 2) Indian staff engineers with some China experience, and 3) local Chinese staff. Second, Infosys was targeting Chinese telecom companies such as China Mobile. Infosys believed that these Chinese companies needed more sophisticated business processes to manage their growth. One major difficulty for Infosys in China was finding sufficient local project management talent.

¶10. (SBU) Interestingly, econoffs' visit came just hours after Mallampooty had honchoed a Chinese group through the Infosys campus, which is a frequently visited showcase for India's IT sector. A major all-government Chinese delegation headed by China People's Political Consultative Conference (CPPCC) National Committee Deputy Chairwoman Liu Yandong, who is also the Director of the United Front Work Department, had toured the premises as part of a swing through the Indian IT heartland. Mallampooty noted that Liu had been surprised by the extent of the media center on the Infosys campus; she wondered why an IT company needed a state-of-the-art broadcasting facility. Mallampooty explained that Infosys can stage and broadcast its own news conferences -- a fact demonstrated the day before when Infosys leaders had broadcast their third quarter earnings results from the campus. (COMMENT: Our host stated that part of the reason for the media center was the difficult traffic situation in Bangalore brought on by the high-tech sprawl within the city and outside. Travel into Bangalore and back to the Infosys campus was very difficult and had helped Infosys decide to install its high end media center. END COMMENT.)

TRUNCATION OF EDUCATION LEADS TO SHORTAGE OF PHDS

¶11. (SBU) Interlocutors touched on staffing and education as major issues, both in India and in China. Wipro, for example, continues to recruit heavily in India and finds that 25 percent of the graduating class of Indian engineers every year are "readily deployable," due to tailored training during the last year of study. This is mostly the result of the pre-placement offer (PPO) system that many Indian firms are using. (COMMENT: This practice is not widespread at China's leading engineering education organizations. END COMMENT.) In addition, Wipro can tap into a large annual graduating class; Ramaiah estimated that there are 1.1 million individuals annually graduating from Indian institutions with three-year degrees.

¶12. (SBU) This instantly deployable workforce, however, has a potential downside. International Institute of Information

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Technology (IIIT) Professor Balaji Parthasarathy later told econoffs that the pressures of IT industry demand for engineers have created major disincentives for people to pursue Master's and PhD degrees. This "truncation of education" is a major problem for India and has resulted in a huge shortage of faculty at Indian IT, science and engineering schools. Foreign multinationals such as Google and Microsoft are finding it hard to recruit PhDs for the research centers they have established in India. The total number of computer science PhDs being awarded by Indian institutes is no more than 100, according to Parthasarathy.

¶13. (SBU) In light of these problems, Parthasarathy also discussed with econoffs the major German connection in Bangalore, where firms like Siemens and Bosch have a significant presence in the same office park where Infosys headquarters is located. The German software giant SAP is currently working with International Institute for Information Technology on an experimental program being conducted only in Bangalore to help fill major personnel shortfalls within the company. Under the program, SAP recruits students in the eighth semester and puts them through a master's program. SAP pays for two years plus a stipend, and the students have the assurance of

a job when they graduate with an advanced degree. Parthasarathy indicated that these students are under no legal obligation to join SAP when they attain their degrees.

¶14. (SBU) Many other companies are interested in this type of arrangement and six more have lined up to participate. Such industry-academic partnerships, designed in part to address the "truncation" problem, were inconceivable 10 years ago according to Parasarathy. The use of adjunct faculty from industry is also flourishing in Bangalore. (COMMENT: Lack of a robust domestic, let alone multi-national corporate-academic partnering of this type is a major shortcoming of China's high-tech development. END COMMENT.) Parathasarathy was quick to term this trend in India "industry driven" rather than "industry led."

IBM: THE REAL WINNERS IN THE "CHINDIA" GAME?

¶15. (SBU) Inder Thukral, Director of Strategy and Business Development at IBM India Private Limited told econoffs that "Chindia" was actually at the front and center of IBM's Asia strategy. While IBM has focused on hardware manufacturing in China, and software, project management and services delivery in India, the firm hopes to leverage both China and India as part of its global strategy. IBM currently has a research lab in New Delhi, a BPO operation in New Delhi, application and services businesses in Hyderabad and Bangalore, and does systems development and engineering services in India. Its biggest company partner in India is Bharti, which provides mobile service under the Airtel brand. IBM India runs the entire IT infrastructure of Bharti/Airtel, which had 18 million subscribers at the end of 2005.

¶16. (SBU) In China IBM has a development lab, an R&D lab, a procurement center, and a small BPO operation that serves primarily customers in Japan, some multinational corporations, and a small portion of the domestic Chinese market. According to Thukral, Japanese firms have been slow to accept global delivery of services from China, and IBM teams are reluctant to source global delivery solutions from China, though this is changing. Echoing a common theme, Thukral stressed that mid-level management expertise is a skill sorely lacking in China. Thukral believed that when it produces a cadre of individuals at this level of mid-management, BPO and similar services will finally take off in China.

¶17. (SBU) In the meantime, IBM wants to have more Indian managers "go global" in the next 2-3 years. Thukral noted a spread in an Indian magazine that touted the ability of Indian managers to thrive in global multinationals. Chinese managers, he observed, simply could not stack up; most firms like IBM use experienced managers from Hong Kong and Taiwan in their China operations. IBM felt confident that its business model of pursuing a global delivery strategy -- with India and China as major platforms -- would ultimately be the real key to unlocking the "Chindia" potential.

¶18. This message was drafted by visiting Washington-based economic officers and cleared by Embassy New Delhi.

HOPPER